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UNCLAS BRATISLAVA 000192

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TAGS: ECON EFIN PGOV ELAB SOCI LO
SUBJECT: ECONOMIC REFORM: THE VIEW ON THE GROUND

¶1. Summary. A radical tax overhaul, price liberalization and tightening of social benefits in recent months have combined to drastically alter the way most Slovaks view their incomes. Approximately 90 new laws came into effect on January 1, 2004 along with a host of other changes in recent months. While the GOS budget and the economy as a whole are on better off, nearly everyone has a new equation to use to calculate his income and many pensioners and unemployed people will be the most affected. Reductions in social benefits have led to social unrest by Slovakia's Roma minority, the vast majority of which are long-term unemployed (septel). Opposition parties and some presidential candidates hope to capitalize on public unhappiness in upcoming elections. End summary.

CUT IN SOCIAL BENEFITS

¶2. Slovakia's generous program of social and unemployment benefits are often blamed as being disincentives for people to find work. The country's unemployment rate is 16 percent, half of which have been out of work for more than two years. Historically, many recipients of unemployment benefits defrauded the system by having jobs on the black market. This allowed them to earn far more than they otherwise could have, and had the double burden of cheating the GOS of income tax revenue and costing it unnecessary benefits payments. On March 1 these benefits will be reduced by approximately 15 percent (short-term unemployment benefits by more than 50 percent) as the GOS introduces a new workfare program. By performing community service or taking jobs at minimum wage, recipients will be able to regain or exceed their previous level of income that was formerly completely dependent on social benefits (unfortunately, it appears that a sufficient number of community service jobs will not be ready in time). Social unrest has broken out within Roma communities, which often have unemployment rates above 90 percent, to protest the cuts in benefits (septel).

19 PERCENT FLAT TAX RATE

¶3. The most drastic change for the general public is a new 19 percent flat tax rate for individuals and corporations. Previously, individuals paid taxes of between 10 to 38 percent divided between five different tax rates, and the corporate rate was 25 percent. While the flat tax is expected to be revenue neutral overall, it represents a large tax cut to higher income earners. The GOS hopes this will encourage them to actually pay their taxes and reduce the rate of tax evasion. (Note: The Slovak National Tax Office estimates that overall 20 to 30 percent of taxes go unpaid in Slovakia.) To help offset the effect of raising lower income earners' taxes from 10 percent to 19 percent, the GOS greatly increased the amount of tax deductions for the working poor. Middle-income earners who are single are likely to pay higher taxes while a family of four would get a nearly 10 percent benefit. However, the National Tax Office told econoff that the new program could hurt pensioners and the unemployed.

19 PERCENT UNIFIED VAT

¶4. Slovakia's previous two-tier value added tax regime was set at 20 percent for most items, but 14 percent for necessities such as food, electricity and natural gas. The rise from 14 percent to 19 percent falls disproportionately hard on people in lower income brackets. In simple terms it equals a five percent increase in inflation for basic necessities. Critics of the new plan note that EU laws do not require a unified VAT. Instead, they specifically allow for reduced VAT on necessities, medicines and other sensitive products.

PRICE INCREASES

¶5. For several years, the GOS has been liberalizing utility prices from their previously highly subsidized rates, and 2004 is the last year of liberalization before prices are considered to be at market rates. Natural gas prices are expected to rise more than 30 percent (including the new VAT rate) for households in 2004 although they will drop by

about two percent for industrial and public sector clients. Electricity prices will increase an average of 6.7 percent (including the new VAT) this year. A local research group predicts a 14 to 20 percent jump in food prices due to the new VAT, increased farm costs and entry into the EU. In August last year, the GOS raised excise taxes on petroleum products, beer and cigarettes that raised the overall price of gasoline and diesel by more than 10 percent, beer by approximately 10 percent and cigarettes by 20 percent

(including a second tax increase in January 2004). These tax increases were initiated to make up for a short fall in tax revenues. To add to consumers' problems, inflation hit its highest rate in four years in 2003 at 9.3 percent and is estimated at 5.5 - 7.3 percent this year.

HEALTHCARE AND COLLEGE NO LONGER FREE

¶6. In June 2003, the GOS initiated a new fee-for-service program in the healthcare sector. Although the fees seem nominal by western standards, they represent a high cost for many Slovaks who consider free healthcare a right of citizenship. Slovakia's healthcare sector is deeply in arrears and its debts are rising due to a public accustomed to frequent doctor visits and doctors that over prescribed drugs (many of which are discarded). The new charges include USD 0.63 for visiting a doctor's office, having a prescription filled, or spending the night in a hospital, although many exemptions were created to minimize the negative effects of this policy. In addition, an increase in the cost of numerous drugs has helped make the Ministry of Health one of the least popular departments of the GOS. However, through the first six months of the plan medical costs are down and the sector's debts are rising at a slower pace. This September, the GOS also plans to introduce the concept of college tuition. Previously free undergraduate and graduate programs will cost approximately USD 125 to 650 per year excluding books, housing and meals.

¶7. Comment. The GOS has made many correct moves in recent years to prepare the country for NATO and EU membership, attract foreign investment, and generally catch up with the development of its neighbors. Furthermore, the USG, the IMF, and other international organizations agree with the recent changes listed above, and have even promoted the idea of reducing social benefits for years. However, the rapid pace at which some of these changes are being implemented -- before adequate numbers of community service jobs could be created and before the jobs created by new foreign investment flooding the country (septel) can take hold -- shows a lack of preparedness on the part of the GOS. Changing a decades-old- culture of living off the dole would prove difficult under the best of circumstances. This view of economic hard times is the backdrop for the upcoming presidential election and referendum on early elections called for by labor unions and opposition parties. Coalition politicians seem determined to stay the course on reforms, but they may pay high political costs by not taking into account how the reforms are viewed by Slovakia's most vulnerable. Opposition parties like SMER and KSS are trying to use this issue to force a government change, and President Schuster is campaigning for reelection on a platform which heavily criticizes the government's actions.

THAYER

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